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Sprint

1850 M Street, N.W., 11th Floor
Washington, D.C. 20036
Telephone: (202) 828 7453

Jay C. Keithley
Vice President
Law and External Affairs
United Telephone Companies

December 10, 1993

Mr. William F. Caton, Acting Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20036

RE: In the Matter of Amendment of Parts 32 and 64 of the Commission's Rules to Account for Transactions Between Carriers and Their Nonregulated Affiliates, CC Docket No. 93-251

Dear Mr. Caton:

Attached are the original and four copies of the Comments of Sprint Corporation in the matter referenced above.

Sincerely,

Jay C. Keithley

Jay C. Keithley
Vice President
Law and External Affairs

Attachment

JCK/mlm

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List A B C D E

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

In the Matter of	)	
	)	
Amendment of Parts 32 and 64 of the Commission's Rules to Account for Transactions Between Carriers and Their Nonregulated Affiliates	)))))	CC Docket No. 93-251

COMMENTS OF SPRINT CORPORATION

Respectfully submitted,

SPRINT CORPORAITON

Jay C. Keithley
1850 M Street N.W.
Suite 1100
Washington, D.C. 20036
(202) 857-1030

W. Richard Morris
Craig T. Smith
P. O. Box 11315
Kansas City, MO 64112
(913) 624-3096

Its Attorneys

December 10, 1993

SUMMARY

Sprint strongly opposes changes to the current rules governing affiliated transactions reporting and valuation. Estimated fair market value ("EFMV") should not be adopted for service transactions because it requires arbitrary and overly subjective decisions concerning availability, comparability and capability of inside resources as compared to nonaffiliate transactions. Development of EFMV for services will not produce useful results.

A "bright line" 75 percent nonaffiliated sales standard to establish prevailing company price is inappropriate. In a competitive market, sales to nonaffiliates are always at market value. Thus, affiliate sales at the same prices as nonaffiliate sales produce market-based results and are reasonable. Any "bright line" test is inherently arbitrary and should not be adopted.

In cases where a tariff, prevailing company price or EFMV (for assets) is not available, the only equitable alternative is the use of fully distributed costs.

Sprint strongly asserts that price caps regulation and other existing mechanisms are more than sufficient controls on potential cross-subsidization and imprudence.

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COMMENTS OF SPRINT CORPORATION

Sprint Corporation ("Sprint") on behalf of the United and Central Telephone companies, North Supply Company, and Sprint/United Management Company ("SUMC"),[1] respectfully provides its comments to the Commission's NPRM in the above referenced proceeding.[2] In the NPRM, the Commission proposes to modify the current system of monitoring of and accounting for transactions between LECs and their non-regulated affiliates. The Commission proposes to increase the level of reporting concerning these transactions and to require the development of estimated fair market value ("EFMV") for service transactions, thus relying more

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1. Sprint Corporation is the owner of the United and Central Telephone companies, North Supply Company and Sprint/United Management Company. North Supply sells telecommunications products and supplies to both affiliates and nonaffiliates. Sprint/United Management Company provides centralized management services to the United and Central Telephone companies.

2. Amendment of Parts 32 and 64 of the Commission's Rules to Account for Transactions between Carriers and their Non-regulated Affiliates, Notice of Proposed Rulemaking, CC Docket No. 93-251, released October 20, 1993 ("NPRM").

extensively on historical rate base regulation concepts even though price cap regulation has been adopted.

Sprint opposes the proposed rule changes because they are unnecessary--the current rules effectively protect ratepayers against abuse in affiliate transactions--and because they impose unnecessary audit and compliance costs.

I. THE EXISTING AFFILIATE TRANSACTION RULES ARE ADEQUATE AND NEED NOT BE MODIFIED

Just two years ago the Commission noted the efficacy of the rules it now proposes to revise. The Commission stated "that our comprehensive system of cost accounting safeguards has worked well . . ."[3] The Commission said their five-pronged scheme of protections "effectively protects against cross-subsidization." This scheme involves: 1) the use of current accounting rules and cost allocation standards; 2) the filing of Cost Allocation Manuals using established standards; 3) independent audits to ensure compliance with cost allocation manual disclosures; 4) detailed ARMIS reporting; and 5) FCC on-site audits.

The Commission concludes that "based on nearly four years experience with cost accounting safeguards, we are convinced that we will be able to continue to enforce these safeguards."[4] In-

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3. In the Matter of Computer III Remand Proceedings: Bell Operating Company Safeguards and Tier 1 Local Exchange Company Safeguards, CC Docket No. 90-623, Report and Order, released December 24, 1991 at para. 46.

4. Id. at para. 54.

deed, the discovery of the improper affiliate transactions between New York Telephone and its Material Enterprises Company affiliate "supports the efficiency of our affiliate transactions rules."[5]

Nothing has transpired since the Commission determined that the current safeguards are adequate to protect against improper affiliate transactions. Because the current standards work well, and no evidence to the contrary has been presented, modifications to the current plan should not be made.

The Commission has stated that it will not "expand reporting requirements" during this trial of price caps.[6] Because changes in reporting such as those proposed in the NPRM would be a breach of this Commission's decision, upon which LECs have relied, it is particularly inappropriate to make modifications prior to the scheduled thorough review of price caps where the effectiveness of price cap control of affiliate transactions may be examined in detail.

The Commission adopted price caps regulation to streamline its regulatory oversight and place more reliance on incentives from market forces to control pricing and potential cross-subsidization. The Commission stated:

> Furthermore, incentive regulation substantially curtails the economic incentive to engage in cross-subsidization. In an environment of in-

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5. Id.

6. In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Order on Reconsideration, released April 17, 1991 at para. 200.

> centive regulation, carriers are limited in their ability to enhance profits by shifting costs from more competitive to less competitive activities, since the cap on prices limits a carrier's ability to raise rates to accommodate the shifted costs. Moreover, incentive regulation eliminates the incentive to shift costs to regulated services from nonregulated services. Under incentive regulation, all a carrier accomplishes by moving costs to regulated services is to depress earnings, not to increase them. Incentive regulation, coupled with our existing regulatory controls to deter cross-subsidy [the requirement that dominant carriers file Cost Allocation Manuals], should substantially discourage anticompetitive activity involving cost shifting between regulated and nonregulated lines of business.[7]

Indeed, the Commission noted that reliance on incentive regulation to police the Commission's cost allocation system was one of the positive aspects of price caps. The Commission said:

> Another important reason for exploring incentive regulation for LECs concerns cost allocations and pricing. Previous orders in this docket have articulated the pressures that a rate of return system places on cost allocation systems. In response to these pressures, the Commission has over time built up a complex system of cost allocation rules that track costs from their inception in the corporate books of account through their allocation to the various telecommunications services LECs provide. Indeed, given the incentives rate of return creates for companies to misallocate costs, thereby threatening our policy of ensuring that rates are based on their fully distributed costs, we spend a great deal of our regulatory resources policing our cost allocation systems. Under incentive regulation, prices would no longer be set by reference to a set of fully distributed costs, but would be set by reference to a formula that tracks aggregate industry costs.

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7. <u>In the Matter of Policy and Rules Concerning Rates for Dominant Carriers</u>, CC Docket No. 87-313, Report and Order and Second Further Notice of Proposed Rulemaking, released April 17, 1989, at para. 104.

> Incentive regulation, by in large measure removing the incentive to misallocate costs between services, may mitigate misallocation as a regulatory concern.[8]

As part of the price cap incentive regulation scheme, the Commission scheduled a thorough review in 1994, after four years price cap experience, to determine the success and, if any exist, shortcomings of the program. This review is not yet due. Yet, in face of the expectations that price cap incentive regulation will control cross-subsidy and cost allocation issues, before evaluation of the incentive regulation system, and without citing any evidence of real problems with the current system of affiliate interest controls, the Commission is proposing onerous and, in Sprint's view, totally unwarranted changes to the monitoring and reporting system dealing with affiliate transactions.

Sprint agrees with the Commission's statements in support of the efficiency of price caps incentive regulation as an effective control over potential affiliate interest transfer pricing abuses. Price caps, along with current safeguards, are more than sufficient to detect and control any abuses that may arise. In view of the lack of documented problems with the current system, creation of expensive new procedures is not justified.

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8. In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Second Report and Order, released October 4, 1990 at para. 34.

II. THE PREVAILING COMPANY PRICE BENCHMARK SHOULD BE REASONABLY ATTAINABLE

The Commission has proposed that the current rule requiring the transfer of assets or services at "prevailing company price whenever the affiliate that provides the asset or service also provides substantial quantities of it to nonaffiliates" should be changed because this price "may be inconsistent with how affiliates deal with each other and may unnecessarily burden both this Commission and carriers."[9] Sprint vigorously opposes this assessment.

In Sprint's view there are three distinct types of organizations involved in affiliate transactions where the LEC pays an affiliate. These are: 1) for profit enterprises that sell substantive quantities of product on the open market; (i.e., North Supply); 2) cost sharing arrangements where system development work is performed on a centralized basis (i.e., Bellcore); and 3) cost sharing arrangements where centralized management services are performed (i.e. Sprint/United Management Company). It is likely that type one and possible that type two affiliate organizations will have outside sales. It is unlikely that type three will have substantive nonaffiliate sales.

In the case of companies that operate in an open market and where competition exists between suppliers, substantive sales to nonaffiliates legitimately establish market value at that point

9. NPRM at para. 15.

in time. For example, as shown by Mr. Steve L. McMahon, Executive Vice President - Operations of North Supply Company, in 1992 Sprint's North Supply Company subsidiary made over 61 percent of its total sales to nonaffiliates.[10] North Supply has over twelve thousand nonaffiliated customers. Additionally, several of these nonaffiliated customers are other LECs, including Pacific Bell, SNET, and Citizens Telephone.[11] Many other telecommunications equipment and supply companies compete for these sales. If North Supply did not provide value in these relationships, the market would quickly go elsewhere. Further, it is the policy of North Supply to sell to its regulated affiliates at the same prices as nonaffiliates receive.[12] Thus, if sales are made to affiliates at the same price as to nonaffiliates, competitive market-based results are achieved.

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10. See, Attachment 1, Affidavit of Steve L. McMahon at para. 13. Sprint expects the proportion of affiliate sales to increase as the Central Telephone companies take advantage of the volume purchasing power they achieve when combined with the United Telephone companies. The total North Supply sales are expected to increase, but because of the addition of Central Telephone Company as a North Supply customer, the proportion of affiliate sales will also increase.

11. Id.

12. Id. at para. 12.

North Supply is involved in such a competitive market. As further shown by Mr. McMahon, a 75 percent outside sales "bright line" test is unreasonably restrictive.[13] As long as nonaffiliate sales are occurring, competitive market-based results are achieved.

As Mr. McMahon shows in his affidavit, North Supply Company operates in a fully competitive market. Not only does North Supply make affiliate sales at the same price as sales to non-affiliates because of the current affiliate pricing rules, but also makes sales at this price because this is the written policy of North Supply.[14] Thus, sales to affiliates are made at market-based prices.

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13. Not only is the 75% bright line test unreasonably restrictive, but it also will add a great deal of unnecessary cost and inefficiencies. For example, Exhibit 1, Attachment B shows that North Supply sells products to companies like Pacific Bell and other local exchange companies. Thus, when North Supply sells Product A to Pacific Bell at price X, there is absolutely nothing wrong or suspect with that sale at that price. However, if North Supply sells the same Product A to a United or Central company, price X suddenly becomes suspect, simply because the 75% bright line test is not met. The United or Central company will then have to undertake the considerable work effort and expense to determine the estimated fair market value versus the cost of North providing Product A in order to determine which is lower. The addition of this time and cost to the business, in these circumstances, is a waste and seems contrary to the Commission's stated goals "of choosing an economically efficient cost allocation methodology and of choosing a methodology that can be feasibly implemented and audited." (In the Matter of Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, CC Docket No. 86-111, Report and Order, 2 FCC Rcd. 1298 (1987) at para. 114) and reliance on price caps regulation to control all forms of LEC expenses.

14. See, Attachment 1 at para. 12.

Mr. McMahon shows that North Supply provides better prices to the United and Central Telephone company affiliates than they could obtain on their own because of the volume purchasing power that aggregating their purchases with nonaffiliate purchases brings to North Supply. Thus, North Supply brings both market prices and superior value to its transactions with affiliates.[15]

The United and Central Telephone companies are not required by contract or otherwise, to purchase from North Supply. Mr. McMahon indicates that when he was an executive in an United Telephone affiliate, that he had the freedom to purchase from multiple suppliers and that he exercised that freedom. He explains that nothing has transpired to change that relationship.[16]

The Commission assumes that North Supply sales to affiliates are made with less effort and with lower transaction costs than sales to nonaffiliates. Mr. McMahon shows that this assumption is incorrect and that North Supply must dedicate extensive sales efforts to affiliate sales in order to win this business in the competitive market. The Commission's assumption that "extensive marketing efforts" are not required when North Supply deals with affiliates and that individual transactions "generally involve

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15. Attachment 1 at para. 11.

16. Id. at para. 8.

lower transactional costs" when sales by North Supply are to affiliates is unsubstantiated and, indeed, is flatly wrong.[17]

As Mr. McMahon states in his affidavit, the marketing effort to the United and Central Telephone companies is comparable to the marketing effort to nonaffiliates.[18] Further, he shows that the individual transaction costs are comparable.[19] Indeed, North Supply lacks "guaranteed sales contracts" with its affiliates but has some with nonaffiliates.[20] As stated by Gregory Mann of Greenwich Associates, the proposed 75 percent standard for use of prevailing company price is theoretically insupportable in a competitive market such as the one North Supply operates in.[21] Furthermore, Mr. Mann opines that such a 75 percent standard is unnecessary in a competitive market place because there is neither a demonstrated nor a nonarbitrary basis to support the Commission's assumption that affiliate transactions, in a competitive market and which are based upon prevailing company price, have an inherent bias that advantages nonregulated affiliates.

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17. Id. at para. 18.

18. Id. at para. 6.

19. Id.

20. Id. at para. 7.

21. See, Attachment 2, An Assessment of the FCC Notice of Proposed Rulemaking on the Affiliate Relationships of Sprint North Supply Company, by Gregory L. Mann, Ph.D., Managing Vice President, Greenwich Associates.

The second type of organization that makes sales to affiliated LECs is exemplified by Bellcore, which, while it may have sales to nonaffiliates, is often a monopoly supplier. United and Central Telephone lack any corporate affiliation with Bellcore. Bellcore's owners are the RBOCs who use Bellcore to perform research, system design, and software design projects for the RBOCs on a cost-sharing cooperative basis. For example, Bellcore produced 800 database software which is used by the RBOCs. Because these products are already sunk costs, the RBOCs sometimes recoup some of these expenses through licenses to nonaffiliates like United and Central Telephone.

As a result, Sprint understands the reluctance of the Commission to conclude that all nonaffiliate sales automatically translate into an approximation of market value. However, as explained above, when the market is competitive, the result of sales to nonaffiliates is a very dependable indicator of value. But in cases such as the Bellcore example, where no other or few sources of supply are available, outside sales cannot reliably be used as benchmarks of market value. Sprint believes that in these cases, the use of fully distributed cost is the only equitable approach.

Third, other business organizations are created to provide the centralized expertise, coordination, and control needed in an industry characterized by rapid technological change, high capital investment, and scarce management resources. Often, these centralized operations also provide cost savings through consolidation. However, even without cost savings occurring through centralization, centralized control, management, and coordination is required. Sprint/United Management Company ("SUMC") is an example of such an organization.

In this respect, the Commission must clearly understand the profound differences between the Bell companies and the United and Central Telephone companies. In the entire predivestiture Bell System there were only 22 companies. These are now aligned under seven RBOCs. There are currently 20 United and Central Telephone companies. With all of the access lines of these companies combined, all the United and Central Telephone companies are less than half the size of an RBOC and far smaller than many of the companies such as Pacific Bell, New York Telephone and Southwestern Bell. Further, the United and Central Telephone companies operate in largely rural areas and have their headquarters in smaller, geographically dispersed cities.

For example, in 1992 United Telephone of Eastern Kansas had total revenues of $37,413,707, United Telephone Company of the Carolinas had total revenues of $49,193,069, and United Telephone Company of the West had revenues of $20,791,415. In comparison, Southwestern Bell had 1992 revenues of $7,758,766,518, Pacific

Bell had revenues of $7,777,604,435, and New York Telephone had revenues of $7,669,651,000.[22] Clearly, a large company like Pacific Bell, New York Telephone or Southwestern Bell, operating in a major city, has the ability to attract and employ the expertise it needs. However, companies like the small United and Central companies lack this ability.

The Commission is incorrect in its assumption that each of the United and Central Telephone companies has available, or reasonably could have available on a local basis, the skilled technology evaluation experts, technology evolution planners, engineering experts, federal regulatory practitioners, capital market experts, and others that are required to run a modern telecommunications company.[23] Even if qualified individuals were available at each of the 20 United and Central Telephone companies, which they are not, the lack of coordination caused by such dispersion would destroy the established standards, and would result in the creation of many small companies that lack standardization, volume purchasing power, and a clear view of the future.

The loss of this centralized guidance in these times of rapid technological change, required capital investment, and uncertainty would present insurmountable problems to these small

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22. See, 1993 Statistics of the Local Exchange Carriers for the Year 1992, United States Telephone Association.

23. NPRM at para. 42.

companies that would otherwise lack access to needed management planning and coordination.

As Mr. Mann shows in his paper, centralization of these functions is vital to the long term success of the small United and Central Telephone companies and to their ability to provide high quality, technologically up-to-date services to their customers.[24]

SUMC, like Bellcore, also uses the cost sharing concept but generally lacks outside sales. For example, SUMC provides centralized support services to the United and Central Telephone companies. In the case of SUMC, costs generally vary depending on the volume of service requested by the United and Central Telephone companies. SUMC has no incentive to sell these services to nonaffiliates because additional work brings a need for additional workers and costs would increase in proportion to the sales to nonaffiliates. Because SUMC is predominately a cost center and not a profit center, the United and Central Telephone companies generally would not benefit from outside sales of this type of service.[25]

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24. See, Attachment 3, An Assessment of the FCC Notice of Proposed Rulemaking on the Affiliate Relationships of Sprint/United Management Company, by Gregory L. Mann, Ph.D., Greenwich Associates.

25. SUMC does provide 800 database and LIDB storage and query services to nonaffiliated LECs. The revenues from these services are recorded as expense reductions to the United and Central Telephone companies.

The Commission notes that "carriers themselves could supply all the resources they obtain from these nonregulated affiliates."[26] However, if each of these companies provided on its own the full range of services required to meet operational and regulatory requirements, costs for many of these services would increase significantly. Centralization, where experts on various matters can be shared, provides significant cost savings to the individual LECs.

Because of the pressure on cost that price caps has brought through its mandatory productivity adjustment as well as competitive market pressures, LECs are driven to minimize cost. Centralized provisioning of services where subject matter specialists can cost effectively meet the needs of many small LEC affiliates is an answer to this challenge. The use of companies like SUMC to provide these cost savings to the user LECs is both reasonable and prudent.

Sprint fails to understand why the Commission suggests that if the individual United and Central Telephone companies provide needed services within their own company, albeit often at much higher cost than on a centralized basis, the Commission would not question that decision. This incentive works at counter purposes with incentives to become more productive through establishment of centralized service organizations like SUMC. For example, it

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26. NPRM at para. 42.

is clearly more expensive to produce 20 separate tariffs, 20 separate sets of comments to Commission proceedings, 20 separate employee benefits plans, and 20 separate technology assessment centers then it is to centralize these functions and perform them only once. Yet the Commission appears to suggest that it would not question a decision to decentralize these operations, but does question the decision to centralize these functions.

In this context, Sprint asserts that price cap and market mechanisms provide more than sufficient control. Further, because appreciable nonaffiliate sales of these management services do not take place, fully distributed costs are the only equitable method of transferring these costs back to the regulated company that benefits from centralization.

The Commission's assumption that sales to nonaffiliates can never be relied upon as a gauge of value is not correct. Clearly, substantive sales are the only reliable benchmark in competitive markets such as the market in which North Supply operates. However, where competitive market characteristics are not present, such as in the Bellcore example, nonaffiliate sales may represent a partial recovery of sunk costs and may not approximate market value. When a competitive market does not exist Sprint asserts that fully distributed cost produces the most equitable results.

III. SPRINT STRONGLY OPPOSES THE EXTENSION OF ESTIMATED FAIR MARKET VALUE TESTING TO SERVICES

The Commission proposes to extend the asset transfer rules to service transfers. If adopted, transfers of service by an affiliate to a LEC would be at the lower of estimated fair market value ("EFMV") or fully distributed cost, and transfers by a LEC to an affiliate would be at the higher of EFMV or fully distributed cost.[27]

Sprint strenuously opposes the creation of an EFMV test for services. The establishment of EFMV for services is subjective, will be open to significant dispute, and will provide little if any useful information to the Commission. Further, development of EFMV for services will be costly, will require constant updating due to market changes, and because of its limited usefulness will be wasteful of company and ratepayer funds.[28]

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27. NPRM at para. 34.

28. Sprint does not oppose continuing the use of an estimated fair market value ("EFMV") test for assets that are transferred at other than tariffed or prevailing company price. Assets, by their very nature, may be "appraised" and a subjective value established. Often data concerning sales of identical items by others is available and this data is a strong foundation for an EFMV calculation. Because of the availability of substantial information with which EFMV of an asset may be established, its use is not opposed by Sprint.

In the Joint Cost Reconsideration Order, the Commission rejected the use of an EFMV test for services, stating "We believe that such a valuation standard is fraught with the potential for abuse, and would be difficult to monitor."[29] The Commission offers no explanation in the NPRM as to why it is no longer concerned with this potential for abuse.

Sprint asserts than a useful and nonarbitrary EFMV cannot be developed for services. For example, how should the legal services provided by SUMC to the United and Central Telephone companies be valued in an EFMV calculation? The lawyers providing this service are located in the Kansas City area and Washington, D.C. On average, they possess 17 years experience, much of it specifically in telecommunications related matters. Should the EFMV be based on entry level, junior partner, or full partner status in a private law firm? Should the calculation be based on law firm compensation in Dighton, Kansas; Kansas City, Missouri; Washington, D.C.; or New York City? Should the comparable firm specialize in telecommunications matters? What should the Martindale-Hubbel rating of the comparable lawyers be, barely acceptable or very proficient? Answers to these questions will vary greatly.

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29. In the Matter of Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, CC Docket No. 86-111, Order on Reconsideration, 2 FCC Rcd 6283 (1987) at para. 131.

As one can see, no matter how these many questions are answered, the result would be necessary subjective. While the example above applies to attorneys; it could be repeated in connection with accountants, money managers, training personnel, electrical engineers, marketing personnel and all other areas where centralized services are provided.

Because any answer to these questions will be subjective and easily challenged, the value of the answer will be very low. As stated by Mr. Mann "[t]he estimated fair market value of services is extremely difficult to measure objectively, changes significantly over time and is easily misrepresented by interested parties."[30] Mr. Mann notes that while EFMV works well for valuing physical assets, EFMV cannot work for valuing services because any weight given to the three key valuation factors--comparability, availability, capability--is completely subjective and easily manipulated.

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30. See, Attachment 3, An Assessment of the FCC Notice of Proposed Rulemaking on the Affiliate Relationships of Sprint/United Management Company, by Gregory L. Mann, Ph.D., Greenwich Associates, at p. 10.

Based on this showing, the Commission should retain the system where centralized cost center expenses are allocated, based on fully distributed costs, to those that consume the services.[31]

The use of fully distributed costs for allocating centralized cost center expenses is appropriate because price cap LECs lack an incentive to inflate these expenses above levels that their management believes are truly necessary to run the business in a prudent manner.

Price caps incentive regulation relies upon the pressure of mandatory productivity adjustments to drive cost reduction activities by LECs. All one needs to do is read the newspaper to see the impact of competition and price caps incentive regulation upon LECs. The price cap LECs, including the United and Central Telephone companies, are all downsizing in an aggressive manner.

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31. The Commission questions whether there are instances in which overall efficiency is increased by obtaining service from nonregulated affiliates at amounts exceeding the service's EFMV (NPRM at para. 33).

As Sprint argues herein, and as the Commission itself noted in the Joint Cost Reconsideration Order, reliable EFMV for services is difficult to come by. (See note 18 supra.) Even if such information could be obtained for a particular service, the time and expense required for each of the 20 United and Central Telephone companies will surely increase the cost of obtaining that particular service at EFMV and will drive the true EFMV above the fully distributed cost of SUMC providing the service. Furthermore, if each of the United and Central Telephone companies is required to undergo the time and expense of developing EFMV data for each and every individual service currently provided by SUMC, the increased work effort and expense will be the very antithesis of efficiency.

As a result of improvements in technology and centralization, the United and Central Telephone companies have been able to provide high quality service and reduce costs and must continue to do so in order to remain competitive, to meet the demands of mandatory productivity adjustments, and, if the company is well managed, to profit by producing productivity gains that exceed the mandatory productivity adjustment.

Price caps, including the mandatory productivity adjustment, and competition, provide powerful incentives to price cap LECs to reduce cost and to avoid cross-subsidy that relies on regulated services revenues. Because of these factors, the Commission need not institute further controls. The market discipline provided by increasing competition in the LEC regulated markets and the mandatory productivity adjustments provide more than sufficient incentives on LECs to control their costs, avoid imprudence, and avoid cross-subsidy.

EFMV tests for affiliate services do nothing but add additional expenses to LECs. Because sufficient ratepayer protection exists through price caps productivity adjustments and market disciplines, additional EFMV tests are unwarranted and would prove to be counter productive. These tests will neither provide useful information nor provide benefits that outweigh their cost.